



10 may 2010

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Board Members:

Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF), the accounting standard setting body in Mexico, welcomes the opportunity to submit its comments on the Exposure Draft on Financial Instruments (the ED), Amortized cost and Impairment, issued for exposure in November 2009. Set forth below you will find our comments on the topics included in the Exposure Draft.

We believe that this ED is a very good step forward to obtain an adequate matching of the revenues related to financial instruments carried at amortized cost with the recognition of the impairment losses that occur with such financial instruments.

This proposal will avoid impairments being recognized only when there is evidence that certain events have occurred and a financial asset has been consequently impaired, as it is indicated in paragraphs 58 to 65 of IAS 39. Entities usually manage their financial assets on a portfolio basis and not individually. Therefore estimating and recognizing the impairment of the financial assets (credit losses) in a portfolio as a group makes more sense than trying to recognize the loss for each asset and matching the impairment with the revenues related to the financial assets will provide a better view of the results of operations.

Effective return

The objective of the proposed standard indicates that the objective of amortized cost measurement is to provide information about the “effective return” on a financial asset or financial liability. We like very much this new term of effective return, which in the case of financial assets includes expected credit losses. We believe that this is an important term, which should be defined in Appendix A. Likewise, we would suggest that for financial liabilities the term that should be used instead should be “effective cost of financing”, since a return only applies to assets.

We believe that the term “effective return” is very important and should be used extensively in the standard to make it more understandable. One of the main changes from IAS 39, which is not highlighted neither in the proposed standard nor in the introduction, is the change in the definition of “effective interest rate”. The definition in

IAS 39 explicitly indicates that the effective interest rate "...shall not consider future credit losses." The new definition does not mention this.

Therefore the question is if the effective interest rate shall consider the future credit losses of the financial assets. There is no explicit indication in the standard whether it should or not consider them. It may be implicit, but standards should be explicit. If we use the term "effective return" that will encompass both the "effective interest" and the expected losses" there will be no need to change the definition of effective interest rate, which is well known and accepted.

Paragraph 6, indicates that "Amortized cost should be calculated using the effective interest method" and indicates that to accomplish this it should consider the expected cash flows over the remaining life of the financial instrument and the effective interest rate. But it does not indicate that the objective is to determine the effective return, which includes the expected losses.

Someone reading paragraphs 6 to 10, regarding the measurement principles, without considering what is written in paragraph 5 of the objective, may not understand that in the case of assets, the expected future credit losses should be included in the recognition of the amortized cost. Therefore it is very important that paragraph 6(a) indicate at the end "...which include expected credit losses for financial assets to properly determine the effective return"

Also, the first sentence of paragraph 6, should indicate at the end "...to properly determine the effective return for assets and effective financing cost for liabilities" or something similar, to tie the recognition principle with the objective.

Furthermore the term effective return should be used in other parts of the standard, such as in paragraph 13, which uses the terms "gross interest revenue" and "net interest revenue", instead of "interest revenue" and "effective return", which would clearly indicate that effective interest (which should include fees, points, transaction costs, premiums and discounts) is different from effective return, which also considers expected credit losses.

The term "effective return" is a very clear term. Therefore, it should be "coined" and used more extensively in the standard, as the objective of amortized cost measurement is to provide information about the effective return.

Therefore, there would be no need to change the definition of what is "effective interest rate", which is very well understood as a concept that includes interest and items that modify the interest rate (such as fees, points, transaction costs, premiums and discounts), but that does not include credit losses on financial assets, since this is not part of the interest that is agreed upon at the beginning of the transaction by the parties, but an estimate of expected credit losses by the party who has the financial asset.

Specific comments

We have the following comments to the questions included in the Exposure Draft

Question 1

Is the description of the objective of amortized cost measurement in the exposure draft clear? If not, how would you describe the objective and why?

We believe that the first paragraph describes only a portion of the objective, which is allocating interest revenue or interest expense over the expected life of the financial instrument, but does not address credit losses (impairment) in this paragraph, even though the proposed standard is about impairment.

Impairment is not mentioned until the end of the last paragraph of the section on the objective of amortized cost measurement. To make it clear that impairments are part of the “effective return”, the last part of paragraph 5 should be inserted at the end of paragraph 3. If not, it would seem that by just allocating interest revenue amortized cost is automatically determined.

Also, as this standard also applies to trade accounts receivable, it would be preferable that the objective indicate “...allocating revenues, such as interest revenue, and expenses, including impairment, over the expected life of the financial instrument.” If not it would seem that this standard applies only to financial sector entities, which we understand is not the case.

Furthermore, we believe that the definition of amortized cost in Appendix A should include deductions for credit losses (impairment). This was included in the definition of IAS 39, and we believe it should continue to be included in such definition in this Standard.

Question 2

Do you believe that the objective of amortized cost set out in the exposure draft is appropriate for that measurement category? If not, why? What objective would you propose and why?

We believe that the objective, considering our response to Question 1, is appropriate for measuring those assets that would be in the category of amortized cost, as far as the objective is to determine the cash flow to be derived from the asset, which is the effective return.

Question 3

Do you agree with the way the exposure draft is drafted, which emphasizes measurement principles accompanied by application guidance but which does not include implementation guidance or illustrative examples? If not, why? How would you prefer the standard to be drafted instead, and why?

We agree with the way the exposure draft is drafted, since what is important is to establish the principles. The implementation guidance will follow and may be included as an additional appendix or in a separate document. Most of the implementation guidance for the financial sector entities, for which this standard will be crucial, will be issued by local regulators. Therefore, including precise implementation guidance in this project may not be of the best interest of IASB, since it may appear to conflict with local banking regulations even when the substance of this standard is in line with their point of view. Let local regulators issue detailed implementation guidance.

Question 4

- a) *Do you agree with the measurement principles set out in the exposure draft? If not, which of the measurement principles do you disagree with, and why?*
- b) *Are there any other measurement principles that should be added? If so, what are they and why should they be added?*

We believe that the matching of revenues and expenses should be emphasized and, therefore, the correlation of interest revenue with impairment should be more predominant in the principles laid out by the Standard, to properly determine the effective return. In this regard, paragraph 6(a) should indicate at the end "...which include expected credit losses for financial assets"

Also, the first sentence of paragraph 6, should indicate at the end "...to properly determine the effective return" or something similar, to tie the recognition principle to the objective.

Question 5

- a) *Is the description of the objective of presentation and disclosure in relation to financial instruments measured at amortized cost in the exposure draft clear? If not, how would you describe the objective and why?*
- b) *Do you believe that the objective of presentation and disclosure in relation to financial instruments measured at amortized cost set out in the exposure draft is appropriate? If not why? What objective would you propose and why?*

The description of the objective of presentation and disclosure is clear as far as it relates to financial instruments that earn interest (those having a loan characteristic) but does not address those that do not earn interest, such as trade accounts receivable. We understand that this project was prepared to meet the requests of the international financial sector and its regulators, but trade receivables should not be overlooked.

Question 6

Do you agree with the proposed presentation requirements? If not, why? What presentation would you prefer instead and why?

Regarding paragraph 13, we believe the terms "gross interest revenue" and "net interest revenue" should not be used. Instead, following the objective of amortized cost stated in paragraphs 3 to 5, the terms "interest revenue" and "effective return" would be the appropriate terms. Using gross interest revenue may confuse some people as it may be considered that the effects of fees, points, transaction costs and other premiums or discounts are not included in this concept. As we indicated above, the term "effective return" should be "coined" and used in this standard to avoid such confusion.

Question 7

- a) *Do you agree with the proposed disclosure requirements? If not what disclosure requirements do you disagree with and why?*
- b) *What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) and why?*

There are several disclosures that seem to be excessive and, as a result, may confuse the reader of the financial statements. For instance, the disclosure required by paragraph 17 (b) may create more confusion than good information. If management has made its best effort to determine the best possible alternative on which to base its assumptions, indicating the effects under other "reasonably possible" alternatives may create doubts about management's choice of the best alternative.

Also, we believe that disclosures about changes in estimates should not be very detailed. The main reasons for changes in estimates should be disclosed, however it is not clear if the effect of a change of estimation technique has to be disclosed, unless the effect of such change is very significant. We believe that guidance should be included whether it has to be disclosed or not. Too much information may obscure the main facts that are important to appropriately interpret the financial statements.

Question 8

Would a mandatory effective date of about three years after the date of issue of the IFRS allow sufficient lead-time for implementing the proposed requirements? If not, what would be an appropriate lead-time and why?

This proposed standard is closely related to IFRS 9. We believe that both standards should be effective on the same dates. Even if IFRS 9 has several concepts that can be implemented regardless of the amortized cost and impairment concepts, this proposed standard is key for the measurement of all those financial instruments that will be in the category of amortized cost. The implementation effort will differ among entities, depending on the quality and depth of their databases to build their credit losses statistics.

Therefore, what may be considered sufficient lead-time for some entities may not be for others. Further the required lead-time may vary from country to country, since in some countries expected credit losses are already considered in determining the expected return on financial assets. We believe that the point of view of local regulators is of high importance in this regard. The Basel Committee should be consulted, as most of local regulators adhere to its directives.

Question 9

- a) Do you agree with the transition requirements? If not, why? What transition approach would you propose instead and why?*
- b) Would you prefer the alternative transition approach (described above in the summary of the transition requirements)? If so, why?*
- c) Do you agree that comparative information should be restated to reflect the proposed requirements? If not, what would you prefer and why? If you believe that the requirement to restate comparative information would affect the lead-time (see Question 8) please describe why and to what extent.*

We believe that comparative information is necessary, since without it the information would be meaningless for several years. However, we consider that the point of view of a standard setter may not be the main factor to consider in the transition. Assuming that financial sector regulators are in agreement with the new concepts (being more prudent), it is more likely that in each jurisdiction they will discuss the transition issues with the local financial sector entities and agree with them on a transition that would be considered appropriate for their jurisdiction. Therefore, we believe that in this regard the point of view of regulators is very important.

Regarding comparative information, we believe that determining the difference in the effective interest rate based on IAS 39 versus that of paragraph 25 of this proposed standard will create some confusion, because readers will need to understand what factors are included under each standard. In this regard we suggest comparing the “effective return rate” (see paragraph 5) with the previous “effective interest rate”. Using

different names for different concepts will facilitate the understanding of the transition requirements. Using the same name for a different concept will not.

Question 10

Do you agree with the proposed disclosure requirements in relation to transition? If not, what would you propose instead and why?

We believe that the term effective interest rate may not be clear for many users of financial statements. What should be required is to disclose the effect of recognizing the effective return, which includes expected losses, instead of just comparing effective interest rates based on this standard and IAS 39.

Question 11

Do you agree that the proposed guidance on practical expedients is appropriate? If not, why? What would you propose instead and why?

Regarding paragraph B16, the first practical expedient appears to contradict the objective of this proposed standard, since the use of a provision matrix of past due accounts would be a way to determine credit losses that have occurred on trade receivables, instead of losses that may occur. Therefore, revenues would be affected later than when the revenue that generated the trade receivable was recognized. The use of a matrix could help to corroborate that the estimate of credit losses based on past experience in relation to sales is adequate, but not to determine expected credit losses. When an account receivable is past due there is already evidence of an existing credit loss, which should be taken into consideration to revise the estimate based on historical experience.

Regarding paragraph B17, it states a practical expedient "...in lieu of the effective interest method..." This suggests that the effective interest rate includes the expected credit losses; however, this has not been explicitly indicated in the proposed standard. It may be implicit due to the change in the definition of the effective interest rate and other concepts, but it is not explicit. The practical expedient indicated in this paragraph is in line with the presentation requested in paragraph 13. Therefore it is the way to determine the "effective return" as previously discussed.

Question 12

Do you believe additional guidance on practical expedients should be provided? If so, what guidance would you propose and why? How closely do you think any additional practical expedients would approximate the outcome that would result from the proposed requirements, and what is the basis for your assessment?

Paragraph 15 and the first part of paragraph 17 are principles related to practical expedients and paragraph 16 and part of paragraph 17 are examples. One example may be included for each principle and any other examples should be part of the implementation guidance that is presently being prepared by the Expert Advisory Panel.

In our outreach activities to evaluate the proposed standard, we have discussed the draft with representatives of selected banks in Mexico. They support the concept of recognizing expected losses, based on the effective return concept discussed above. They do have a specific comment regarding the change in estimate discussed in paragraph B4, and the removal of a specific asset from a portfolio to be added to a

different portfolio where the expected cash flows may be estimated individually for such financial asset.

They emphasized that the practice in the banking industry is to stop accruing interest when a credit is considered as impaired, since it is unlikely that any further interest will be collected. Therefore it would be convenient that paragraph B4 indicates that in estimating individually the cash flows for such financial assets, the non accrual of interest should be considered. This is the general practice in the banking industry worldwide. Moreover, in the United States there is a release of the Office of the Controller of the Currency, which establishes such guidance, which is recognized as an accounting principle for USGAAP purposes. We recommend that the standard indicates that this is a practical expedient to determine the future cash flows of impaired loans, when the local banking regulator has established such practice.

Other comments

We have comments on certain paragraphs, as follows:

- Paragraph 18 refers to “...*gains and losses resulting from changes in estimates in relation to financial assets and liabilities that are measured at amortized cost*”. We believe reference should be made only to financial assets, which can be subject to changes in estimates. The question of changes in the value of liabilities measured at amortized cost is not dealt elsewhere in the draft and the recognition of the effect of own credit on liabilities is very controversial. Even if we do oppose to such recognition, as the exposure draft does not deal with that topic, we do not agree that this reference be made, since it would seem that the recognition of change in liabilities measured at amortized cost, due to own credit, is accepted.
- Likewise, paragraph B1 refers to financial assets and liabilities. This is correct for the items indicated in (a) and (b), but paragraph (c) indicates “...*from the effect of revising estimates of expected cash flows (eg regarding prepayments or uncollectibility) at each measurement date*.” We believe that “of financial assets” should be added after “...*cash flows*...” to indicate that this only applies in the case of financial assets.

Should you require additional information on our comments listed above, please contact Juan M. Gras at (52) 55 5596 5633 ext. 105 or me at (52) 55 5596 5633 ext. 103 or by e-mail at jgras@cinif.org.mx or fperezcervantes@cinif.org.mx, respectively.

Sincerely,

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